

ALCATEL-LUCENT MALAYSIA SDN BHD & ANOR

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v.

KETUA PENGARAH HASIL DALAM NEGERI

HIGH COURT MALAYA, KUALA LUMPUR

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AZIAH ALI J

[JUDICIAL REVIEW NO: R1-25-166-2008]

20 DECEMBER 2010

REVENUE LAW: *Income tax - Obligation to deduct withholding tax - Whether applicant duty bound to make or deduct any withholding tax in relation to services relating to provision of global network communication - Services wholly performed outside Malaysia - Whether withholding tax payable pursuant to s. 109 and/or s. 109B Income Tax Act 1967 - Whether payment for services were royalties and therefore subject to withholding tax*

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The 2nd Applicant had been providing services relating to the provision of a global network for voice, data and video communication ('the Services') to the 1st applicant which the applicants claimed were wholly performed outside Malaysia as all the servers for the network were located outside Malaysia. The respondent conducted a withholding tax audit at the 1st applicant's premises after which the respondent issued a letter dated 31 October 2007 to the 1st applicant stating that the 1st applicant had not complied with withholding tax provisions for years of assessment 2001-2005. The 1st applicant was asked to pay RM4,891,747. The respondent gave no reason why the payments to the 2nd applicant were subject to withholding tax. The amount was later reduced to RM1,507,674.80. Still no reason was given why the payments were subject to withholding tax. Upon query by the applicant's tax agent, the respondent stated that the withholding tax was to be paid pursuant to s. 109 and/or s. 109B of the Income Tax Act 1967 ('the ITA'). The applicants contended that payments made by the 1st applicant to the 2nd applicant for the Services provided by the 2nd applicant to the 1st applicant ('the payments') were not subject to withholding tax since the Services were wholly performed outside Malaysia. The applicants applied for judicial review under O. 53 of the Rules of the High Court 1980 ('the RHC') for, *inter alia*, the following reliefs: (i) an order of *certiorari* to quash the

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- A respondent's decision in its letter dated 14 April 2008 ('the respondent's letter') that the payments were subject to withholding tax under ss. 4A and 109B and/or 109 of the ITA and were further subject to increased withholding tax under ss. 109(2) and/or 109B(2) of the ITA ('the respondent's decision'); (ii) a
- B declaration that the respondent's decision was erroneous in law and that the payments were not subject to withholding tax or increased withholding tax under ss. 4A and 109B and/or 109 of the ITA; and (iii) in the alternative, a declaration that the respondent's basis of computing the increase was excessive and
- C erroneous. The issues before the court were: (a) whether the respondent's failure to give reason why the payments were subject to withholding tax was unreasonable; and (b) whether the respondent erred in its decision that the payments were royalty within the definition of 'royalty' under s. 2 of ITA or whether the
- D payments were for services provided by the 2nd applicant to the 1st applicant.

Held (allowing the application with costs):

- E (1) Sections 109 and 109B refer to two different scenarios where withholding tax is imposed. The documents produced showed that the first time that the respondent informed the applicants that the payments were royalties and were therefore subject to withholding tax was *vide* the respondent's affidavit in reply.
- F There was failure on the part of the respondent to give due consideration to relevant matters at the material time when making the decision that the payments were royalties and subject to withholding tax. Public interest demands that a statutory power must be exercised reasonably and with due
- G consideration. In the circumstances of the case, it was unreasonable of the respondent to apply both ss. 109 and 109B. Applying both ss. 109 and 109B rendered the respondent's decision unreasonable. (para 18)
- H (2) The respondent relied on art. 2 of an unsigned draft agreement (exh. AP2) to support the contention that the payments were subject to withholding tax by virtue of being royalty payments. However, the respondent had relied on an incorrect basis of fact since exh. AP2 was an unsigned agreement and related to other years of assessment. Hence the
- I respondent's decision was fundamentally flawed. (para 19)

- (3) There was no evidence to show that the Service Agreement was entered into by the applicants with the intention of allowing the use of software by the 1st applicant to produce profits. A perusal of the Agreement showed that it was an agreement by which the 2nd applicant agreed to provide services to the 1st applicant to facilitate access to the global network for voice, data and video communication to enable the 1st applicant to connect to the worldwide telecommunication network. There was no evidence that the payments were made for the grant of rights by the 2nd applicant to the 1st applicant to develop commercially or exploit the software. On the contrary the Service Agreement showed that any payment for software was necessary for the acquisition of the 2nd applicant's services required by the 1st applicant for the 1st applicant's business. Hence, the respondent erred in its conclusion that the payments were royalties. The respondent had failed to read the Service Agreement as a whole. The decision of the respondent that the payments were subject to withholding tax on the ground that the payments were royalties was a decision that no reasonable decision-maker similarly circumstanced would have come to. (para 21)

Case(s) referred to:

- Bharat Sanchar Nigam Ltd v. Union of India & Ors* [2006] 3 SCC 1 (**refd**)
Commissioner of Income Tax v. Neyveli Lignite Corporation Ltd [2000] 459 [v. 243] (**refd**)
Exxon Chemical (Malaysia) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2005] 4 CLJ 810 (**refd**)
FC of T v. Sherritt Gordon Mines Limited 77 ATC 4,365 (**refd**)
Kelab Lumba Kuda Perak v. Menteri Sumber Manusia, Malaysia & Anor [2005] 3 CLJ 517 (**refd**)
Majlis Perbandaran Pulau Pinang v. Syarikat Bekerjasama-sama Serbaguna Sungai Gelugor dengan Tanggungan [1999] 3 CLJ 65 (**refd**)
MUI Finance Berhad v. Menteri Kewangan, Malaysia [1994] 2 CLJ 630 (**refd**)
National Land Finance Co-operative Society Ltd v. Director General of Inland Revenue [1993] 4 CLJ 339; [1993] 4 BLJ 33 (**refd**)
R v. Windsor Licensing Justices, ex parte Hodes [1983] 2 All ER 551 (**refd**)
Rekapacific Bhd v. Securities Commission & Anor & Other Appeals [2005] 2 CLJ 108 (**refd**)
Secretary Of State For Education And Science v. Tameside Metropolitan Borough Council [1977] AC 1014 (**refd**)

- A *The Minister of National Revenue v. Wain-Town Gas And Oil Company Limited* [1952] 2 SCR 377 (*refd*)
The Queen v. St John Shipbuilding & Dry Dock Co Ltd [1981] 1 FC 334 (*refd*)

Legislation referred to:

- B Income Tax Act 1967, ss. 2(1), 4A, 15A, 109(2), 109B(2)
Rules of the High Court 1980, O. 53
- For the applicant - Goh Ka Im (Irene Yong with him); M/s Shearn Delamore & Co*
- C *For the respondent - Noor Hisham Ahmad (Arsyad Hasanuddin with him); IRB*
- Reported by Amutha Suppayah*

D **JUDGMENT**

Aziah Ali J:

- E [1] The 2nd applicant has been providing services relating to the provision of a global network for voice, data and video communication (“the services”) to the 1st applicant which the applicants say were wholly performed outside Malaysia as all the servers for the network were located outside Malaysia.
- F [2] The respondent conducted a withholding tax audit at the 1st applicant’s premises after which the respondent issued a letter dated 31 October 2007 to the 1st applicant stating that the 1st applicant had not complied with withholding tax provisions for years of assessment 2001-2005. The 1st applicant was asked to pay RM4,891,747. The respondent gave no reason why the
- G payments to the 2nd applicant were subject to withholding tax. The amount was later reduced to RM1,781,274. The 1st applicant’s tax agent, PricewaterhouseCoopers Taxation Services Sdn Bhd (“PWC”) wrote to the respondent to explain why the
- H payments made for services provided by the 2nd applicant were not subject to withholding tax. By letter dated 28 March 2008 the respondent reduced the amount to RM1,507,674.80. The applicants say that still no reason was given why the payments were subject to withholding tax. PWC wrote to the respondent to ask which withholding tax provision applied to the payments.
- I In response by a letter dated 14 April 2008 (exh. PC11) the

respondent stated withholding tax of RM1,507,674.80 is to be paid to the respondent pursuant to s. 109 and/or s. 109B of the Income Tax Act 1967 (“the ITA”). The 1st applicant paid the RM1,507,674.80 under protest.

[3] The applicants challenge the decision of the respondent requiring the applicants to pay withholding tax and increased withholding tax totalling RM1,200,806 for “leased communication facilities” under item (ii) of annexure 1 to exh. PC11 as follows:

(ii) Perbelanjaan Utilities - Leased Communication Facilities

Bil	Tahun Terakhir Berakhir/Tahun Taksiran	Belanja Yang Dituntut (RM)	Cukai Pegangan yang Sepatutnya Dibayar (RM)	Kenaikan Cukai Pegangan (RM)	Catatan
4.	31.12.05 / TT 2005	1,524,844	116,334.95	116,334.95	Seksyen 109 dan/atau 109B, ACP 1967
5.	31.12.04 / TT2004	1,426,444	108,827.72	108,872.72	Seksyen 109 dan/atau 109B, ACP 1967
6.	31.12.03 / TT 2003	1,634,004	124,663.09	124,663.09	Seksyen 109 dan/atau 109B, ACP 1967
7	31.12.02 / TT 2002	1,721,736	131,356.43	131,356.43	Seksyen 109 dan/atau 109B, ACP 1967
8.	31.12.01 / TT 2001	1,562,670	119,220.81	119,220.81	Seksyen 109 dan/atau 109B, ACP 1967
	Jumlah	7,869,698	600,403.00	600,403.00	

The applicants contend that payments made by the 1st applicant to the 2nd applicant for the services provided by the 2nd applicant to the 1st applicant are not subject to withholding tax since the services were wholly performed outside Malaysia.

[4] By way of this application the applicants apply for judicial review under O. 53 of the Rules of the High Court 1980 (“the RHC”) for the following reliefs:

- A (a) an order of *certiorari* to remove into this Honourable Court for the purpose of it being quashed the respondent's decision, contained in the respondent's letter dated 14 April 2008 (hereinafter referred to as "the respondent's letter") that the
- B payments made by the 1st applicant to the 2nd applicant in the years of assessment 2001 to 2005, for services provided by the 2nd applicant to the 1st applicant relating to the provision of a global network for voice, data and video communication (hereinafter referred to as "the payments") referred to under the sub-heading "Perbelanjaan Utilities -
- C Leased Communication Facilities" in the respondent's letter, are subject to withholding tax under ss. 4A and 109B and/or s. 109 of the Income Tax Act 1967 (hereinafter referred to as "ITA") and are further subject to increased withholding tax under ss. 109(2) and/or 109B(2) of the ITA (hereinafter referred to as "the respondent's decision");
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- (b) a declaration that the respondent's decision is erroneous in law and that the payments are not subject to withholding tax or increased withholding tax under ss. 4A and 109B and/or
- E 109 of the ITA;
- (c) a declaration that, in the event the 1st applicant is liable to payment of an increased withholding tax under ss. 109(2) and/or 109B(2) of the ITA, which the applicants deny, the respondent's basis of computing such an increase is excessive and erroneous;
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- (d) an order of prohibition to prohibit the respondent from taking any further proceedings arising from the respondent's decision or any similar decision or finding of the respondent in regard to payments by the 1st applicant to the 2nd applicant;
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- (e) an order of *mandamus* to compel the respondent to refund to the 1st applicant the withholding tax and increased withholding tax in the sum of RM1,200,806 which were withheld and remitted under protest to the respondent on 28 April 2008, and any and all overpayments of withholding tax, debts, increases or tax arising from the grant of any relief by this Honourable Court;
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- I (f) costs; and
- (g) such further, alternative, consequential or other relief as this Honourable Court deems fit.

[5] The issues before the court are:

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- (a) whether the failure of the respondent to give reason why the payments were subject to withholding tax is unreasonable;
- (b) whether the respondent erred in its decision that the payments made by the 1st applicant to the 2nd applicant is royalty within the definition of 'royalty' under s. 2 of ITA or whether the payments were for services provided by the 2nd applicant to the 1st applicant as contended by the applicants.

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Submissions

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[6] Counsel for the applicant submits that ss. 109 and 109B of ITA covers different types of payments. Section 109 covers interest and royalty while s. 109B covers amongst others payments for services in relation to property, technical advice, assistance or services or rent. Section 109 of ITA provides as follows:

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109. Deduction of tax from interest or royalty in certain cases.

- (1) Where any person (in this section referred to as the payer) is liable to pay interest or royalty derived from Malaysia to any other person not known to him to be resident in Malaysia, other than interest or royalty attributable to a business carried on by such other person in Malaysia, he shall upon paying or crediting the interest (other than interest on an approved loan or interest of the kind referred to in paragraph 33 or 35 of Part I, Schedule 6) or royalty deduct therefrom tax at the rate applicable to such interest or royalty, and (whether or not that tax is so deducted) shall within one month after paying or crediting the interest or royalty render an account and pay the amount of that tax to the Director General:

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Provided that the Director General may under special circumstances allow extension of time for tax deducted to be paid over.

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Section 109B provides as follows:

109B. Deduction of tax from special classes of income in certain cases derived from Malaysia.

- (1) Where any person (in this section referred to as "the payer") is liable to make payments to a non-resident:

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- A** (a) for services rendered by the non-resident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such non-resident;
- B** (b) for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or
- C** (c) for rent or other payments made under any agreement or arrangement for the use of any moveable property,

D which is deemed to be derived from Malaysia, he shall, upon paying or crediting the payments, deduct therefrom tax at the rate applicable to such payments, and (whether or not that tax is so deducted) shall within one month after paying or crediting such payment, render an account and pay the amount of that tax to the Director General:

- Provided that the Director General may under special circumstances allow extension of time for tax deducted to be paid over.
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F Section 15A sets out when fees specified under s. 109B are deemed to be derived from Malaysia. Counsel submits that pursuant to the proviso to s. 15A, such fees are not deemed to be derived from Malaysia if the services are not performed in Malaysia. Section 15A provides as follows:

15A. Derivation of special classes of income in certain cases.

Gross income in respect of:

- G** (a) amounts paid in consideration of services rendered by a person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;
- H** (b) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
- I** (c) rent or other payments made under and agreement or arrangement for the use of any moveable property

shall be deemed to be derived from Malaysia:

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(i) if responsibility for payment of the above or other payments lies with the Government, a State Government or a local authority;

(ii) if responsibility for the payment of the above or other payments lies with a person who is a resident for that basis year; or

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(iii) if the payment of the above or other payments is charged as an outgoing or expense in the accounts of a business carried on in Malaysia;

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Provided that in respect of paragraphs (a) and (b), this section shall apply to the amount attributable to services which are performed in Malaysia.

[7] Counsel submits that by requiring the 1st applicant to pay withholding tax without giving any reason but by merely listing the two provisions of ITA shows that the respondent had not focused his mind and had made the decision requiring tax to be withheld on the payments even though he had not arrived at a clear conclusion on which of the two legal provision was applicable. Counsel submits that:

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(a) if the respondent is in the first place uncertain and unclear as to which legal provision requires tax to be withheld on the payments, then it is fundamentally unreasonable to require tax to be withheld on the payments;

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(b) stemming from this uncertainty, the respondent was unable to provide any reason to the applicants for the respondent's decision to require tax to be withheld on the payments;

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(c) the wholly mechanical and unreasonable action of the respondent without any reasons being given for requiring tax to be withheld on the payments is a clear case for the application of relief by way of an order of *certiorari* to quash the decision of the respondent (*MUI Finance Berhad v. Menteri Kewangan, Malaysia* [1994] 2 CLJ 630; *R v. Windsor Licensing Justices, ex parte Hodes* [1983] 2 All ER 551).

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[8] It is submitted that the respondent has failed to adhere to the basic principles of natural justice by failing to give reasons for his decision thus depriving the applicants of the opportunity to explain or make a case based on the facts as to why the payments

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- A were not subject to withholding tax and to effectively dispute the respondent's decision. Counsel submits that failure by a decision-maker to give reasons for his decision is a violation of the principles of procedural fairness and natural justice leading to a justifiable ground of intervention by a court of judicial review. In support counsel cites the cases of *Kelab Lumba Kuda Perak v. Menteri Sumber Manusia, Malaysia & Anor* [2005] 3 CLJ 517; *Majlis Perbandaran Pulau Pinang v. Syarikat Bekerjasama-sama Serbaguna Sungai Gelugor dengan Tanggungan* [1999] 3 CLJ 65; *Rekapacific Bhd v. Securities Commission & Anor & Other Appeals* [2005] 2 CLJ 108.

- [9] Counsel further submits that it is fundamentally unreasonable to require tax to be withheld when the respondent is uncertain as to which withholding tax provision applies as indicated by the listing of both ss. 109 and 109B. Section 109 imposes withholding tax on royalty whilst s. 109B imposes withholding tax on payment for specified services. Counsel submits that listing both ss. 109 and/or 109B cannot be considered as an explanation for the respondent's decision as both sections deal with different scenarios. This shows that the respondent was unsure and could not determine which provision applies. It is submitted that the respondent was acting mechanically to cover the scenarios under both provisions which the respondent thought may be applicable. Therefore it is submitted that the respondent's decision was so unreasonable that no reasonable person would have come to it and that this is a proper case for an order of *certiorari* to quash the respondent's decision. Counsel submits that due to the respondent's uncertainty therefore the respondent was not able to provide any reason at the material time. It is submitted that the failure of the respondent to inform the applicants of the specific provision relied on by the respondent in imposing withholding tax has deprived the applicants of the opportunity to put forward their case.

- [10] Counsel refers to the respondent's affidavit in reply (encl. 14) and submits that this is the first time that the respondent is contending that the payments were royalty and subject to withholding tax under s. 109 of ITA. In para. 4 and 5 of the respondent's affidavit it is averred as follows:

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4. Saya mohon merujuk kepada perenggan 11, 13 dan 16 Afidavit Pemohon-pemohon dan menegaskan bahawa Responden telah menjelaskan kepada Pemohon-pemohon di dalam surat-surat bertarikh 31.10.2007, 18.01.2008 dan 28.03.2008 sebagaimana ekshibit-ekshibit PC-5, PC-7 dan PC-9 (Afidavit Pemohon-Pemohon) yang menyatakan bahawa terdapat beberapa isu ketidakpatuhan oleh pemohon-pemohon terhadap peruntukan cukai bagi bayaran dibuat atas royalti.

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5. Ketidakpatuhan tersebut adalah di mana pemohon-pemohon gagal memotong dan membayar cukai atas royalti yang diterbit dari Malaysia kepada mana-mana orang lain yang tidak dikenali olehnya sebagai pemastautin di Malaysia. Kegagalan pemohon-pemohon memotong dan membayar cukai atas bayaran tersebut menjadikan pemohon-pemohon gagal mematuhi peruntukan Akta Cukai Pendapatan 1967 (ACP).

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[11] Counsel submits that the respondent has failed to give adequate or sufficient explanation how the payments came within the definition of 'royalty'. It is submitted that 'royalty' as defined under s. 2(1) of ITA include:

(a) any sums paid as consideration for the use of, or the right to use:

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(i) copyrights, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks, or tapes for radio or television broadcasting, motion picture films, films or video tapes or other means of reproduction where such films or tapes have been or are to be used or reproduced in Malaysia or other like property or rights;

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(ii) know-how or information concerning technical industrial, commercial or scientific knowledge, experience or skill;

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(b) income derived from the alienation of any property, know-how or information mentioned in paragraph (a) of this definition.

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Counsel cites the High Court of Australia case of *FC of T v. Sherritt Gordon Mines Limited* 77 ATC 4,365 wherein Jacobs J said:

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- A It appears to me that the essential feature of a royalty in modem usage in the secondary sense of the word is a payment for a benefit or advantage which the payee can provide to the payer and which can be used for some production or extraction or treatment based upon that which is provided where the amount of the payment is proportionate to the extent of that use or that
- B production extraction or treatment. I do not think that the benefit or advantage which the payee provides need necessarily be something in which the payee has rights against the whole world, rights of property. It is sufficient if something is provided which is regarded as valuable to the payer and which he becomes
- C entitled as between himself and the payee to put to use in his activity of production extraction or treatment.

- Counsel submits that based on the abovementioned case, ‘royalty’ refers to payments made for the use of intellectual property rights like copyrights, patents, trademarks or some means of reproduction
- D or specialized know-how or information and what is obtained in return by the payer is something valuable which he can put to use for some production, extraction or treatment. It is submitted that in the present case, there are no intellectual property rights, means
- E of reproduction or specialized know-how or information provided by the 2nd applicant to the 1st applicant. There was nothing used by the 1st applicant for some production, extraction or treatment.

- [12] It is submitted that what was provided by the 2nd applicant were services that a third party telecommunication provider like Telekom Malaysia Berhad would provide to facilitate the 1st applicant’s access or connection to the global network for voice, data and video communication and the payments were accordingly charged for the services provided. As illustration counsel refers to
- F the Indian Supreme Court case of *Bharat Sanchar Nigam Ltd v. Union of India & Ors* [2006] 3 SCC 1 as follows:
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- A subscriber to a telephone service could not reasonably be taken to have intended to purchase or obtain any right to use electromagnetic waves or radio frequencies when a telephone connection is given. Nor does the subscriber intend to use any portion of the wiring, the cable, the satellite, the telephone exchange etc As far as the subscriber is concerned, no right to the use of any other goods, incorporeal or corporeal, is given to him or her with the telephone connection.
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Providing access or telephone connection does not put the subscriber in possession of the electromagnetic waves any more than a toll collector puts a road or bridge into the possession of the toll payer by lifting a toll gate. Of course the toll payer will use the road or bridge in one sense.

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Dr AR Lakshmanan SCJ said:

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The contract between the telecom service provider and the subscriber is merely to receive, transmit and deliver messages of the subscriber through a complex system of fibre optics, satellite and cables ...

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Traditionally, a contract for carriage of goods or passengers is by roadways, railways, airways and waterways. This is associated with carriage of tangible goods. Such a carrier has no right over the goods of the customer and does not effect transfer of right to use any goods used by the carrier of the goods. On this analogy, the petitioners carry messages. They are only carrier and have neither property in the message nor effects any transfer to the subscriber. The advancement of technology should be so absorbed in the interpretation that this method of carriage of message should also be understood as carriage of goods and not a transfer of a right to use goods, if any.

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Therefore counsel submits that the payments were not royalties but were payments for services rendered by the 2nd applicant in relation to facilitation of access to the global network for voice, data and video communication to enable the 1st applicant to connect to the worldwide telecommunication network to exchange voice, data and video in relation to communication outside Malaysia as all servers for the network were located outside Malaysia. It is submitted that the service agreement entered into on 1 January 2003 (exh. PC3) between the 2nd applicant and the 1st applicant refers to 'services'. Counsel submits that this is similar to services provided by a third party telecommunication provider like Telekom Malaysia Berhad and the payments were akin to communication charges paid by a subscriber of the services of Telekom Malaysia Berhad or any third party telecommunication provider. Therefore counsel submits that there is no basis in law for the respondent to require tax to be withheld on the payments which were clearly not royalty. Counsel submits that the respondent's decision is so unreasonable that no reasonable person similarly circumstanced would have come to it.

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- A [13] Counsel refers to the case of *National Land Finance Co-operative Society Ltd v. Director General of Inland Revenue* [1993] 4 CLJ 339; [1993] 4 BLJ 33 on the interpretation of revenue/ taxing statutes as follows:
- B There are ample authorities to show that courts have refused to adopt a construction of a taxing Act which would impose liability when doubt exists. In *Re Micklewait* it was held that a subject was not to be taxed without clear words. We realize that revenue from taxation is essential to enable the Government to administer the country and that the courts should help in the collection of
- C taxes whilst remaining fair to taxpayers. Nevertheless, we should remind ourselves of the principle of strict interpretation as stated by Rowlatt J in *Cape Brandy Syndicate v. Inland Revenue Commissioners*:
- D ... in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used ...
- E It has also been said by the Judicial Committee in *Oriental Bank Corp v. Wright* 'that the intention to impose a charge upon a subject must be shown by clear and unambiguous language'.
- F ... There is therefore a doubt whether the legislature had intended to impair the existing right of the taxpayer and inflict a detriment to it as it takes away a vested right under the existing law to exemption from tax. As there is a doubt, the ambiguity must be construed in favour of the taxpayer as the said exemption from tax has not been removed by sufficiently clear words to achieve that purpose.
- G Counsel also refers to *Exxon Chemical (Malaysia) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* [2005] 4 CLJ 810 and the judgment of Gopal Sri Ram JCA (as he then was) as follows:
- H ... the principle that a provision in a taxing statute must be read strictly is one that is to be applied against revenue and not in its favour. The maxim in revenue law is this: no clear provision; no tax. If there is any doubt then it must be resolved in the taxpayer's favour The corollary of that proposition is that those parts in a revenue statute that favour the taxpayer must be read liberally.
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[14] For the reasons above counsel submits that the respondent's attempt to require tax to be withheld on the payments under s. 109 of the ITA even though the payments not being royalty within s. 109 of the ITA is clearly *ultra vires* and unreasonable. A

[15] For the respondent learned revenue counsel submits that based on the finding by the respondent pursuant to the tax audit carried out, the respondent was of the view that the payments made by the 1st applicant to the 2nd applicant falls under the definition of 'royalty' and is subject to withholding tax. It is submitted that the definition of 'royalty' under s. 2 of ITA is wide and is not limited to what is included in its definition under s. 2. Counsel relies on the Indian case of *Commissioner of Income Tax v. Neyveli Lignite Corporation Ltd* [2000] 459 [v. 243] which says as follows: B C

The term 'royalty' normally connotes the payment made by a person who has exclusively right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. D E

[16] Counsel submits that the payments made by the 1st applicant to the 2nd applicant, a non-resident, were for the right to use software and falls within the definition of 'royalty'. In support counsel refers to the following provisions in the service agreement (exh. AP2) between the applicants as follows: F

Article 3: Service

3.1 Alcanet International agrees to provide and the Customer accepts to be provided with the Services described and specified in Annex 1 to the Contract. G

Article 12: Software

12.1 The Customer acknowledge that the majority of Alcanet International Services requires concluding Software licence agreements as part of this Contract. H

12.2 The Customer recognises that the copyright in Software included in the Services, in whatsoever form it may be embodied, and specifically including but not limited to computer programs or modules thereof, whether expressed in source code or object code, and documents relating thereto, I

A is owned by Alcanet International or used by the latter under license from a third party copyright holder. The Customer recognises that the present Contract does not grant it any rights in or to the software other than as specified thereunder.

B 12.3 Alcanet International grants to the Customer the non-exclusive, non-transferable right to use the Software delivered with the Service.

C Therefore it is submitted that under the service agreement the 1st applicant was granted the right to use the software owned by the 2nd applicant.

D [17] In reply counsel for the applicants submits that the service agreement exh. AP2 referred to by revenue counsel is an unsigned draft agreement relating to other years of assessment and is not the subject of this application and is therefore irrelevant. It is submitted that by relying on an unsigned draft agreement exh. AP2 relating to other years of assessment shows that the entire basis of the respondent's decision is fundamentally flawed as the Respondent has relied on an incorrect basis of fact (*Secretary Of State For Education And Science v. Tameside Metropolitan Borough Council* [1977] AC 1014). Counsel for the applicants submits that the respondent has failed to read the service agreement as a whole. It is submitted that the service agreement is not an agreement for the right to use software as contended by the respondent but is an agreement for services for which payments were made. Case law shows that the term 'royalty' means payments for "exclusive rights" for which the payer could exploit the "exclusive rights" and from which profits could be produced (*The Queen v. St John Shipbuilding & Dry Dock Co Ltd* [1981] 1 FC 334; *The Minister of National Revenue v. Wain-Town Gas and Oil Company Limited* [1952] 2 SCR 377). Counsel further refers to the Commentary on the Model Tax Convention on Income and on Capital (OECD Model Tax Convention) on which Malaysia's double tax treaties are based which made the following conclusion on the tax treatment of software:

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52. The conclusions of the said Committee are that:

I (a) Payments made in connection with software represent royalties within the meaning of Article 12 only in circumstances where there is a limited grant of rights (not amounting to a change in ownership) for the commercial

development or exploitation of the software. Payments for software, whether “bundled” or not, which is acquired for the personal or business of the purchaser do not represent royalties.

A

Decision

B

[18] The respondent avers that the respondent had explained to the applicants *vide* the letters exhs. PC5, PC7 and PC9 that there was non-compliance with regard to withholding tax for the payments made as royalties. A perusal of the three letters referred to shows that both ss. 109 and 109B ITA were mentioned. I agree with counsel for the applicants that ss. 109 and 109B refers to two different scenarios where withholding tax is imposed. The documents produced show that the first time that the respondent informed the applicants that the payments were royalties and were therefore subject to withholding tax was *vide* the respondent’s affidavit in reply encl. 14. In my opinion there was failure on the part of the respondent to give due consideration to relevant matters at the material time when making the decision that the payments were royalties and subject to withholding tax. Public interest demands that a statutory power must be exercised reasonably and with due consideration. I agree with counsel for the applicants that in the circumstances of this case it was unreasonable of the respondent to apply both ss. 109 and 109B. I find that applying both ss. 109 and 109B renders the respondent’s decision unreasonable.

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[19] The respondent relied on art. 2 of the unsigned draft agreement exh. AP2 to support the contention that the payments were subject to withholding tax by virtue of being royalty payments. However as submitted by counsel for the applicants and with whom I agree, the respondent had relied on an incorrect basis of fact since exh. AP2 is an unsigned agreement and relates to other years of assessment. Hence the respondent’s decision is fundamentally flawed.

G

[20] In *The Queen v. St John Shipbuilding & Dry Dock Co Ltd* [1981] 1 FC 334 cited by counsel for the applicants, the Federal Court of Appeal of Canada held:

H

“Royalties”, though a broad term, when used in the sense of a payment for the use of property, connotes a payment calculated by reference to the use or to the production or revenue or profits from the use of the rights granted. In *Jowitt’s Dictionary of English Law* the term is defined thus:

I

- A “Royalty”, a payment reserved by the grantor of a patent, lease of a mine or similar right, and payable proportionately to the use made of the right by the grantee. It is usually a payment of money, but may be a payment in kind, that is, of part of the produce of the exercise of the right. See RENT.
- B Royalty also sometimes means a payment which is made to an author or composer by an assignee or licensee in respect of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent.
- C [21] In the present case there is no evidence to show that the service agreement was entered into by the applicants with the intention of allowing the use of software by the 1st applicant to produce profits. A perusal of the agreement shows that it is an agreement by which the 2nd applicant agreed to provide services to the 1st applicant to facilitate access to the global network for voice, data and video communication to enable the 1st applicant to connect to the worldwide telecommunication network. There is no evidence that the payments were made for the grant of rights by the 2nd applicant to the 1st applicant to develop commercially or exploit the software. On the contrary the service agreement shows that any payment for software was necessary for the acquisition of the 2nd applicant’s services required by the 1st applicant for the 1st applicant’s business. In the applicant’s affidavit in reply affirmed by Darren Matthew Ridge it averred *inter alia* as follows (para. 14 encl. 15):
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- E
- F The Second Applicant being a mere remote telecommunication service provider never developed or exploited any rights to use of any kind and payments made by the First Applicant to the Second Applicant in years of assessment 2001 to 2005 were specifically only for the Services provided by the Second Applicant to the First Applicant.
- G
- H Hence I agree with the applicants that the respondent erred in its conclusion that the payments were royalties. The respondent had failed to read the service agreement as a whole. In my opinion the decision of the respondent that the payments were subject to withholding tax on the ground that the payments were royalties is a decision that no reasonable decision-maker similarly circumstanced would have come to. For the reasons stated I allowed the application with costs of RM4,000 to the applicants.
- I
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